

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
REUTERS LTD.	:	DETERMINATION
for Redetermination of Deficiencies or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Years 1977,	:	
1978 and 1979.	:	

Petitioner, Reuters Ltd., 1345 Avenue of the Americas, New York, New York 10105, filed a petition for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1977, 1978 and 1979 (File No. 800880).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 7, 1987 at 1:15 P.M., with all briefs filed by February 16, 1989. Petitioner appeared by Philip T. Kaplan, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation constitutionally applied Tax Law §§ 208 and 210 and the regulations at 20 NYCRR 3-2 and 3-8 in computing petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base.

II. Whether computation of petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base violated Article 24 of the US-UK Tax Convention.

FINDINGS OF FACT

At all times relevant herein, the years 1977, 1978 and 1979 (the "audit period"), petitioner, Reuters Ltd. ("Reuters"), was a corporation organized in the United Kingdom engaged in the business of supplying news and economic and financial information by electronic means to newspapers, banks, insurance companies and others interested in such information. Reuters' operations were worldwide, doing business in approximately 80 countries, mainly through branch offices of the English company. The principal offices of the corporation were located in the United Kingdom, while its New York office was the main office in the United States. During the period in issue, Reuters was not incorporated in the State of New York.

Pursuant to the terms of the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains (the "US-UK Tax Convention"), Reuters' maintained a United

States branch, with offices in New York. Its office was a "permanent establishment", defined by the convention as a "fixed place of business through which the business of an enterprise is carried on." (Tax Convention, Article 5[1]; Article 5 [2][a].)

For purposes of the franchise tax imposed by section 209 of the Tax Law, Reuters is an "alien" corporation, i.e., a corporation "organized under the laws of a country other than the United States." (20 NYCRR 3-8.3.)

During the period in issue, Reuters filed corporation franchise tax reports with the State of New York and United States income tax returns of a foreign corporation with the Federal government. Said reports were also filed with the government of the United Kingdom. United Kingdom tax liability was computed against a basis comprised of income earned by Reuters from its operations throughout the world. The tax imposed by the United States Internal Revenue Code was computed against a basis of income, gain or loss attributable to United States sources only. For the purposes of this determination, such a computational basis will be referred to as "water's edge" income, which is in compliance with the specific provisions of the U.S.-U.K. Tax Convention. The New York franchise tax liability of Reuters was imposed against a basis comprised of allocated Federal taxable income plus all other income earned outside of the United States, as adjusted by specific deductions. These adjustments were made in accordance with the regulation at 20 NYCRR 3-2.3(9).

As stated above, Reuters filed corporation franchise tax reports for each of the calendar years in issue. For the year 1977, Reuters computed its New York liability against an allocated worldwide income base. The original return was prepared by Coopers and Lybrand which stated in an attached page that the return was true, correct and complete, based on all information relating to the matters required to be reported in the return. For the years 1978 and 1979, Reuters computed its New York tax liability against only the United States source income. In 1981, Reuters amended its 1977 filing to conform to the subsequent reports, using the United States income base. For each of the years in issue, taxable net income on the corporation franchise tax reports reflected a loss.

The gross revenues of the United States permanent establishment represented a maximum of 15% of Reuters' worldwide gross revenues for each of the years in issue.

An audit was performed by the Division of Taxation between September of 1980 and September of 1983 covering the period in issue. Although all aspects of the corporation franchise tax reports for each year were analyzed, the only disputed issue was whether the Division was restricted by the tax convention from calculating Reuters' income for corporate income tax purposes by applying the three-factor formula (property/receipts/payroll) to worldwide income.

Although it was suggested that Reuters file using a worldwide basis for its entire net income, it chose to amend its 1977 corporation franchise tax report and file for each of the three years of the audit period based upon United States income alone. Therefore, for the year 1977, Reuters is claiming a refund of \$30,011.00, representing the difference between tax recomputed using a United States basis of income (a loss) versus a worldwide basis as used in the computation of tax on the original 1977 report.

The Division of Taxation recomputed New York entire net income for each of the years in issue against a base of allocated worldwide income, gain, and loss. The Division computed 1977 franchise tax liability against the income base as originally reported. For the years 1978 and 1979, the Division used worldwide income as reflected in Reuters' published annual reports, since other sources were not provided by Reuters, despite requests by the Division.

On October 14, 1983, the Division issued to Reuters Ltd., three statements of audit adjustment and three notices of deficiency which set forth the following:

<u>Period Ended</u>	<u>Tax Deficiency</u>	<u>Interest</u>	<u>Total Due</u>
12/31/77	\$ 814.00	\$ 519.00	\$ 1,333.00
12/31/78	\$385,982.00	\$212,614.00	\$598,596.00
12/31/79	\$464,407.00	\$215,764.00	\$680,171.00

Following a conference held on November 7, 1985, and based upon additional information provided by Reuters, additional tax due was recomputed for each of the years in issue, as follows:

<u>Year</u>	<u>Additional Tax Due</u>
1977	\$ 973.00
1978	\$50,609.00
1979	<u>\$44,586.00</u>
Total	\$96,168.00

Therefore, the amount of additional tax due remaining in dispute is \$96,168.00. The additional information supplied by Reuters only 13 days after the informal conference included data on the worldwide net profit of Reuters, excluding foreign subsidiaries, and calculated the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages. The information was sent by Michael Crombie, Taxation Manager of Reuters, to Ms. Regina Jaffe, conferee, on November 20, 1985. The letter stated, in pertinent part:

"The attached schedules provide data on the worldwide net profit of Reuters Limited, excluding foreign subsidiaries and calculates the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages."

An analysis was performed by Reuters to demonstrate additional costs which would be incurred were it to be directed to comply with the Tax Law and corporation tax regulations relating to the calculation of corporation franchise tax based on worldwide income. Reuters' analysis included a partial list of adjustments to local book income in nearly 80 countries including currency conversion, accounting methods, depreciation, compensation and fringe benefits, gains and losses on sales and exchanges of assets, and interest expenses and losses on transactions between related taxpayers. These would be Federal adjustments while for New York purposes Reuters would have to eliminate dividends and interest received from its subsidiaries, add back interest and other amounts attributable as carrying charges to subsidiary capital and eliminate 50% of any dividends from corporations which were not subsidiaries during the periods in issue. The study also calculated the costs of complying with tax filing requirements for the years 1977 through 1979 including an estimate of local costs of making book conversions, the cost of establishing a U.S. staff to supervise the work of overseas personnel in making conversions, and various estimated departmental costs. By way of summary, the analysis estimated a start-up cost for the accounting changes of approximately \$86,000.00 and recurring annual costs of over \$680,000.00 in order to calculate Reuters' New York entire net income in the manner desired by the Division pursuant to the New York State Tax Law and regulations promulgated thereunder. Additionally, the analysis indicated that Reuters would have to value its worldwide real property and tangible personal property at fair market value on a quarterly basis in order to properly calculate its New York business allocation

percentage. Said process was projected to cost no less than \$300,000.00 per year.

For each of the three years in issue, Reuters had a subsidiary, IDR, Inc., which was a New York corporation. Reuters held 99.5% of the voting stock of IDR, Inc. in the years 1978 and 1979 and 93.8% of the voting stock in 1977. For all three years, 100% of IDR, Inc.'s value was allocated to New York State.

Reuters did approximately 15% of its business in the U.S. during the period in issue. For 1977, Reuters reported a worldwide business allocation percentage for New York State of 9.3853%. (The amended return reported 56.0999% based on United States source income.) The 1978 Franchise Tax Report indicated a business allocation percentage of 53.689% and 60.515% for 1979. Subsequently, Reuters conceded business allocation percentages for 1978 of 10.19% and 1979 of 8.39%, using worldwide income as a denominator.

CONCLUSIONS OF LAW

A. Since the issues involved in this case relate directly to the application of the New York Tax Law and regulations promulgated thereunder, it is necessary to first establish jurisdiction of the Division of Tax Appeals to hear and decide this matter. Although neither side has contested the jurisdiction to decide issues concerning the applicability of statutes and regulations to the instant facts, the parameters of the Tax Appeals Tribunal's scope of review should be clear at the outset. This scope has been described as follows:

"The Tribunal's enabling legislation does not extend our scope of review to determine the facial constitutionality of Tax Law statutes (Fourth Day Enterprises, Tax Appeals Tribunal, October 27, 1988); however, we may determine whether Tax Law statutes are constitutional as applied (see, Matter of David Hazan, Inc., Tax Appeals Tribunal, April 21, 1988). From this authority it follows that we may determine whether the Commissioner's regulations are constitutionally valid, both facially - as in the instant case - and as applied (20 NYCRR 3000.11[e][3])." (Matter of J.C. Penney Co., Inc., Tax Appeals Tribunal, April 27, 1989.)

Therefore, the issue of whether the application of the New York statutes and regulations are violative of specific provisions of the United States Constitution will be determined herein.

B. The United States Constitution gives Congress the exclusive authority to regulate United States commerce with foreign nations. (US Const, art I, § 8, cl 3.) Concurrent with the broad grant of authority over foreign commerce, Congress is also given the power to enter into treaties with these foreign nations. (US Const, art VI, cl 2.) A treaty, as the supreme law of the land, is binding on the States (Hauenstein v. Lynham, 100 US 483 [1879]), and treaty provisions will be liberally construed to effect their purpose. (Neilson v. Johnson, 279 US 607 [1928]; Geoffrey v. Riggs, 133 US 258 [1889]; United States v. A.L. Burbank & Co., Ltd., 525 F2d 9, cert denied 426 US 934.) If a state law, and specifically a state-imposed tax, directly conflicts with a treaty provision, the terms of the treaty will prevail. (Scandinavian Airlines System v. County of Los Angeles, 56 Cal 2d 11 [1961], cert denied 368 US 899.)

The Division of Taxation recomputed Reuters' tax liability for the years 1977, 1978 and 1979 based upon the portion of its entire net income allocated within New York State by multiplying its business income by a business allocation percentage (Tax Law 210.3[a]) and its investment income by an investment allocation percentage (Tax Law § 210.3[b]). The heart of the issue in the instant matter is the allocation of Reuters' entire net income, *i.e.*, its total net income from all sources (Tax Law § 210.9). The business allocation percentage is determined by taking the sum of the:

(a) percentage which the average value of real and tangible personal property within New York State bears to average value of all taxpayer's real and tangible personal property wherever situated;

(b) percentage which receipts earned within New York State bear to total receipts within and without New York State, weighted twice; and

(c) percentage which total wages, salaries and personal service compensation less compensation of general executive officers within New York State bears to total wages, salaries and personal services compensation within and without the State;

and dividing the sum by the number of percentages.

The Division of Taxation, following the computational method set forth in Tax Law § 210.3(a), calculated Reuters' business allocation percentage using worldwide figures gleaned from annual reports (these were the only figures available to the Division given Reuters' noncompliance with requests by the Division for better sources of information). The statute's references to the use of figures for property, wages and receipts "within and without" the State implies all sources, and the regulation at 20 NYCRR 3-2.3(a) supports such an interpretation with regard to Reuters, to wit:

"In the case of a taxpayer organized outside of the United States, all income from sources outside the United States less all allowable deductions attributable thereto, which were not taken into account in computing federal taxable income."
(20 NYCRR § 3-2.3[a][9].)

The question then becomes whether the Commissioner's application of the statute and regulations has violated the Foreign Commerce Clause of the Constitution by usurping Congress's complete authority in this area. It is determined that there has been no such violation or assumption in the instant action.

The case law in this area has been eloquently briefed by the parties and mention of it at this juncture is both essential and proper. In Complete Auto Transit, Inc. v. Brady (430 US 274 [1977], reh denied 430 US 976) the application of a Mississippi tax on the "privilege of doing business" within Mississippi to the activity in interstate commerce of a motor carrier in transporting an out-of-state manufacturer's automobiles between points in the state was challenged as violative of the Constitution's Commerce Clause. The Court, finding the tax not to be violative of the Commerce Clause, reiterated the four elements of a successful defense of a Commerce Clause challenge, i.e., that the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.

The tax imposed against Reuters meets these requirements. Reuters, doing business in New York, has a nexus with the state sufficient to subject it to the franchise tax. The tax is fairly apportioned, by application of allocation percentages to the specific tax base, reflecting the degree of petitioner's business transacted in New York. The franchise tax does not per se discriminate against interstate commerce, and, as applied in this matter, the tax is fairly related to services provided to Reuters by New York State.

However, when a state seeks to tax the instrumentalities of foreign commerce, two additional considerations, beyond those set forth in Complete Auto, must be weighed. (Japan Line, Ltd. v. County of Los Angeles, 441 US 434 [1979].) The first is the enhanced risk of multiple taxation, and the second is whether the state tax impairs federal uniformity in an area where federal uniformity is essential.

In Japan Line, the County of Los Angeles and others levied property taxes on large cargo shipping containers that were temporarily within the state. The containers were owned by Japanese shipping companies and had their home ports in Japan, where they were subject to property taxes. The containers were moved on the companies' ships and both the containers and the ships were used exclusively for hire in the transportation of cargo in foreign commerce. The Court refused to decide the case solely on the four tests enunciated in Complete Auto and ruled that the additional considerations of multiple taxation and federal uniformity must be examined as well. The California tax in Japan Line was found to violate the Commerce Clause since it resulted in multiple taxation of instrumentalities of foreign commerce and prevented the United States from "speaking with one voice" in regulating foreign trade. It is noted that the ad valorem tax involved in Japan Line was a property tax not an income tax and that the taxation of such containers was the subject of a U.S.-Japan treaty, viz., the Custom Convention on Containers, which sought to reflect a national policy to remove impediments to the use of containers as "instruments of international traffic." Thus, the California tax frustrated the goal of federal uniformity and invited retaliation from Japan, which did not tax U.S. containers. Also, since the containers were taxed in Japan, the California tax was clearly enhancing the risk of multiple taxation.

Petitioner argues that the franchise tax imposed against Reuters Ltd. is unconstitutional as a violation of the Foreign Commerce Clause because it cannot survive the scrutiny required by the second test set forth in Japan Line. Relying on the U.S.-U.K. Tax Convention, and referring specifically to Article 24, petitioner suggests that the tax as imposed implicates foreign policy issues and/or violates a clear federal directive, i.e., prevents federal uniformity in the area. This issue will be dealt with as part of the discussion of the Tax Convention below.

Petitioner did not address itself to the issue of multiple taxation presumably because the U.K. allows a credit for income taxes paid abroad, rendering the risk of multiple taxation a moot issue herein.

Later cases have discussed the Complete Auto and Japan Line tests in the context of unitary businesses. Although the reasoning in these cases is thought provoking and somewhat analogous to the instant case, none squarely address the circumstances of an alien corporation doing business in branch form in a state.

In Container Corporation of America v. Franchise Tax Board (463 US 159, reh denied 464 US 909) the Court examined a corporate franchise tax imposed by California on income, employing a unitary business principle and formula apportionment in applying that tax to corporations doing business both within and without the state. Like New York, California applied a three-factor formula to apportion the income of the unitary business (payroll, property and sales). The Court found the application of the unitary business principle proper; that the use of the three-factor formula to apportion income was not violative of the constitutional requirement of fair apportionment (from Complete Auto); and that the tax did not violate the Foreign Commerce Clause of the Constitution.

The Container case reaffirmed the general rule that under the Due Process and Commerce Clauses a state may not tax value earned outside its borders when imposing an income tax. This is precisely what Reuters claims New York is doing in the instant matter. But Container recognized that it is not always possible to make precise territorial allocations when businesses operate across state lines. Therefore, the Court held that the Constitution imposes no single formula for apportionment on the state. (Id. at 164.) Further, the Court held that the taxpayer had the burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed. (Id. at 164.)

In this case, Reuters operated as a single enterprise with its headquarters in the United

Kingdom. It operated branches in approximately 80 countries during the audit period, each of which collected and sold news, financial information, etc. to various types of customers (Finding of Fact "1"). Reuters does not present the unitary business problem which appeared in Container Corporation of America v. Franchise Tax Board (*supra*), Barclays Bank Int'l. v. Franchise Tax Board, (Cal Super Ct, June 16, 1987, Paras, J.) and Colgate Palmolive Co. v. Franchise Tax Board, (Cal Super Ct, December 12, 1988, Gardner, J.). Further, New York State was not a unitary business jurisdiction during the audit period and the income of an alien parent or subsidiary would not have been considered in the calculation of entire net income. (See 20 NYCRR § 6-2.5[b].)

Rather, this case closely resembles Bass, Ratcliff and Gretton, Ltd. v. State Tax Commission (266 US 271 [1924]), in which the Supreme Court held that Bass Ratcliff, a British ale manufacturer, doing business in New York State through a branch which only operated as a sales office, was subject to the New York franchise tax for the privilege of doing business in the State. The tax was not defined as a direct tax on allocated income but a tax on the privilege of doing business in a given year measured by the allocated income accruing from the business in the preceding year.

The Court in Bass Ratcliff succinctly described the scenario of an alien corporation doing business in New York:

"So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places--the process of manufacturing resulting in no profits until it ends in sales--the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business." (*Id.* at 282.)

The business of Reuters can not be distinguished. Its New York branch collected and disseminated news etc. as an inextricable cog in the international news agency mechanism which was Reuters Ltd. Its income during the audit period was derived from worldwide operations of approximately 80 branches, all comprising one enterprise, Reuters Ltd. Just as in Bass Ratcliff, the State of New York was justified in attributing to New York a just proportion of the profits earned from its worldwide business operations.

Although the Container court was dealing with a unitary business involving overseas subsidiaries, its rules of fair apportionment are pertinent to the Reuters facts. In Container the Court said that the formula for apportionment must have internal consistency so that if it were applied by all jurisdictions it would result in no more than all of the unitary business's income being taxed. (Container Corp. of America v. Franchise Tax Board, *supra*, at 169.) It also said that there must be external consistency as well, *i.e.*, the factors used in the formula must actually reflect a reasonable sense of how income is generated. (*Id.* at 170.)

The fact that an apportionment formula may result in taxation of some income that did not have its source in the taxing state is not fatal, but the formula would not withstand the Court's scrutiny if the taxpayer showed that the income attributed was out of all proportion to the business transacted in that state. (*Id.* at 170.) Further, the three-factor formula of payroll, property and sales has been approved by the Court. (Butler Bros. v. McCollgan, 315 US 501 [1942].) Given these rules, it is found that the three-factor apportionment formula used by the Division was fair and not out of proportion to the business transacted by Reuters in New York for the years in issue; at least Reuters has not shown that such apportionment was out of all proportion to the business transacted in the State. The fairness of those percentages discussed in Finding of Fact "13" was not questioned by Reuters and their proximity to the percentage

reported by Reuters on its original 1977 report indicate that they were fair estimations.

What was questioned was whether the apportionment formula resulted in discrimination against foreign commerce. Reuters' strongest arguments concern the United States - United Kingdom Income Tax Convention and the "ostensible neutrality" of the tax statutes and regulations which impose the tax on alien taxpayers using an allocated worldwide entire net income. However, before reaching those two issues, two recent California cases which have found California's unitary taxation theory unconstitutional should be examined.

The first case is Barclays Bank Int'l. v. Franchise Tax Board (supra) which involved a foreign parent corporation whose foreign subsidiary did business in California, both directly and through a California subsidiary. The Franchise Tax Board determined that this was a unitary business and computed income tax using the worldwide combined reporting method ("WWCR") even though 98.5% of the income of the unitary group was derived from sources outside the U.S. and only 1.5% of the unitary income was attributable to California. The court found that the WWCR method imposed an impermissible burden on foreign commerce and thus violated the Due Process Clause of the U.S. Constitution. Also, the court found that since federal uniformity was essential, the case did not meet the uniformity test in Container. The Court ruled that the arm's length/separate accounting method, with all its flaws and imperfections, is utilized by the Internal Revenue Service and by all nations of the world and does not unfairly and systematically discriminate against foreign nationals and should have been used in Barclay's.

Reuters analogizes itself to Barclay's Bank with particular emphasis on the alleged impossibility of compliance with the unitary tax requirements. As in Barclays, Reuters claims that it was discriminated against because only foreign multinationals are placed in the position of foregoing available New York tax benefits, and paying higher taxes; or spending a million dollars annually to file a correct New York franchise tax report; or discontinuing business in New York altogether.

In Colgate Palmolive Co. v. Franchise Tax Board (supra), the Franchise Tax Board imposed the franchise tax on Colgate Palmolive Co. which had a controlling interest in 75 foreign subsidiaries. The Franchise Tax Board used the WWCR method of accounting in calculating Colgate's tax, which the taxpayer paid and then filed for refund. The trial court judge ruled that Container was not a reliable precedent because that case hinged on the government's failure to take a position on the issue of a state's right to use a unitary taxation scheme. The judge noted that since the Container decision, the President had instructed the Secretary of the Treasury and Attorney General to pursue the policy of arm's length/separate accounting for calculation of a multinational's in-state income. The judge also noted the executive's authority to establish national policy without the consent of the legislature and that too much should not be made of Congress's inaction on the unitary tax issue. He claimed that if Congress wished to express an opinion contrary to that of the executive, it easily could have done so.

Neither of these cases supports Reuters' petition in this matter. First, as stated above, the instant case does not concern the unitary business issue. There was no effort by the State of New York to combine the income of a Reuters' subsidiary or parent having no connection to or nexus with the State. The Division correctly noted that Reuters was a single, incorporated entity engaged in the business of media services throughout the world. Reuters did not conduct its New York business through a subsidiary but through a branch and New York taxed only that portion of its income allocable to New York. It did not combine the incomes of several related corporations as was the case in Barclays and Colgate-Palmolive. In fact, even if this were a case where New York might permit or require the combination of income from domestic subsidiaries of a multinational parent, items of income, gain and/or loss attributable to alien

corporations would not be included. (See 20 NYCRR § 6-2.5[b].) The business of Reuters is very closely analogous to Bass, Ratcliff and Gretton v. State Tax Commn. (*supra*) and it would be a mistake to confuse it with a unitary business involving separate corporations.

However, the issues raised in Container and Japan Line and reexamined in Barclays and Colgate-Palmolive with regard to multiple taxation and federal uniformity must be discussed.

From the facts presented, there does not seem to be a problem of multiple taxation. Petitioner's own witness testified that there is no taxation by political subdivisions within the United Kingdom and therefore the issue of symmetry does not exist. On the basis of the record, if all countries taxed Reuters on its apportioned worldwide net income it would not surpass the total amount of tax due. Further, the same witness conceded that Reuters would receive a credit against United Kingdom tax for all such foreign taxes paid.

Moreover, New York's taxing scheme for alien corporations does not deprive the United States from speaking with one voice. This is not a unitary situation where New York seeks to tax income of related companies without a rational apportionment formula. The instant case features State taxation of an alien entity with worldwide operations some of whose income must be fairly apportioned to New York. Where a company chooses to enter a taxing jurisdiction like New York with full knowledge of its tax laws and chooses to do business in a form with less than the most advantageous tax position, it must have a reason for so conducting its business.

For whatever reason, Reuters chose not to form a subsidiary corporation whereby it would have achieved its goal of arm's length/separate accounting treatment given New York's rule against combining alien income. (20 NYCRR 6-2.5.) It is noted that Reuters had a New York subsidiary, IDR, Inc., for all years in the audit period and had knowledge of the advantages of doing business as a New York subsidiary corporation. Reuters, however, chose to do business as a branch in New York State. "Having elected to conduct their business under this format, and having reaped the benefits thereof, [Reuters] now seek[s] to avoid any disadvantage arising out of the selected format. There is nothing irrational about the [Division's] determination which has the effect of binding the taxpayers to the form of business chosen by them." (107 Delaware Associates v. New York State Tax Commission, 99 AD2d 29 [Casey, J., dissenting], revd on dissenting opn below 64 NY2d 935; Matter of Tops, Inc., Tax Appeals Tribunal, November 22, 1989.) Petitioner's voluntary, informed choice waived arm's length/separate accounting treatment and subjected all its income to the New York apportionment formula. To limit Reuters' income to that earned in the United States would be a distortion of its true New York earnings and create a misconception of its true business operations.

In Colgate-Palmolive the court held that the WWCR method frustrated the ability of the Federal government to "speak with one voice" because:

- (1) it impermissibly interfered with the conduct of foreign affairs by the executive branch of the Federal government;
- (2) it caused conflicts between the United States and foreign nations and led to the adoption of retaliatory legislation; and
- (3) it contravened established federal policy in the field of foreign affairs.

However, when these factors are applied to the situation in Reuters, where one entity was doing business in branch form, it is evident that there was no threat to federal uniformity. The Division seeks to tax only that portion of income allocable to New York in relation to the entire net income of the entity. In this case it just happens to be international. If allocated and

adjusted properly, New York only receives tax on that income earned in this State. To compare its New York income to its Federal source income clearly would be a distortion of the percentage of the business's income attributable to New York State. The Federal government chooses to utilize the arm's length/separate accounting method as a mirror image to the treatment of U.S. companies by the United Kingdom. However, nothing in the U.S.-U.K. Tax Convention, U.S. Constitution or State law prohibits a political subdivision from using an allocation of worldwide net income. As stated above, to use the Federal figures in the instant situation would have created a fiction, not a fair portrayal of Reuters' actual income which should have been apportioned to New York.

The threat of retaliatory legislation is not applicable here. There is no income taxation of U.S. entities by U.K. political subdivisions. If the U.K. wished to allow its political subdivisions to tax the income of multinationals it could do so and such an act would not be retaliatory, rather it would place U.K. political subdivisions on an even footing with their U.S. counterparts. However, if the U.K. sought to impose the WWCR method on U.S. corporations that would contravene the U.S.-U.K. Tax Convention. The New York regulation, on the other hand, does not contravene the U.S.-U.K. Tax Convention or Federal policy.

C. The U.S.-U.K. Tax Convention, signed on December 31, 1975 and entered into force on April 25, 1980 (U.S.-U.K. Income Tax Convention, 1980-81 C.B. 394 et seq.) was discussed at length by both parties in their briefs. The critical provision is Article 24-Nondiscrimination, which stated, in part, as follows:

"(1) Individuals who are nationals of a Contracting State and who are residents of the other Contracting State shall not be subjected in that other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

(2) The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities." (Tax Convention, 1980-81 C.B. 414.)

Although it is conceded that Reuters operated a permanent establishment in the U.S., defined in Article 5(2) as a branch or office, the application clearly relates to the treatment of corporations by the U.S. and U.K., since the income taxation by the states bears no counterpart in the U.K. How can one say that a tax is not more or less favorably levied when there is no symmetry of taxation in both countries? The answer is that such a comparison is not possible.

The Division of Taxation argues that the Senate's refusal to ratify Article 9(4) relating to the prohibition on political subdivisions from taxing the income, deductions, receipts or outgoings of a "related enterprise" establishes, at least tacitly, an acceptance of WWCR and the unitary theory. This issue does not need to be addressed except to the extent it affects the instant factual situation, which it does not. New York does not seek to tax the income of a related entity but the same entity, wherever earned. By doing so it has not breached the terms of the treaty or usurped the Federal government's authority in this area.

The legislative history cited by the Division and the Senate's ultimate reluctance to endorse a prohibition on unitary taxing schemes by states, i.e. its reservation with regard to Article 9(4), clearly indicate that the Reuters scenario was not one which the treaty was intended to prohibit.

The Senate Executive Report No. 95-18 (1980-81 C.B. 411) sets forth explanations of the

various articles of the Treaty. With regard to Article 9 and the limitation on state taxation, it states, in pertinent part, as follows:

"Explanation of Limitation.--The treaty provision prevents a state from extending the unitary method through this combined reporting system to related foreign enterprises where the enterprise doing business in the state is either a British enterprise or is controlled directly or indirectly by a British enterprise.

* * *

However, that state may take into account the income and assets of any other branches of that corporation, wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has." (1980-81 C.B. 420.)

Further, the technical explanation of the treaty by the Treasury Department (1980-81 C.B. 455) discussing Article 9(4), recognized the difference between the unitary business and single enterprise and noted the alternative tax treatment of the latter:

"Because a corporation is considered a single enterprise regardless of how many branches it has, a state may take into account the income and assets of all branches of that corporation, wherever located." (1980-81 C.B. 162.)

Thus, the Division has successfully illustrated that the Treaty did not intend to prohibit New York from imposing a franchise tax against Reuters against a base of its worldwide income.

Reuters argues that it was discriminated against in contravention of Article 9(2) because of the costs of compliance with what it terms "ostensibly neutral" tax statutes and regulations, i.e., those that read as if they treat all taxpayers equally but, in fact, do not.

Reuters submits that the cost of compliance for an alien taxpayer outweighs the tax advantages of so complying. An affidavit submitted post hearing by Michael J. Canty, Financial Manager/Taxation of Reuters, estimated start-up costs for accounting changes alone of \$86,000.00 and a recurring annual cost of \$680,000.00 for calculating Reuters' New York entire net income in accordance with New York law and regulations. Additionally, the cost of valuing Reuters' assets throughout the approximately 80 countries in which it operated branches was estimated to be \$300,000.00 per year.

Although the Division did not contest the accuracy of these estimates, it is noted that Reuters did file its original 1977 corporation franchise tax report using worldwide income figures, and the return was prepared by the accounting firm of Coopers & Lybrand which signed a declaration that the return was a "true, correct and complete return based on all the information relating to the matters required to be reported in this return...." The cost of compliance was not raised as an issue.

Further, after the conference held on November 7, 1985, Michael Crombie, a Taxation Manager for Reuters, sent a letter to the conferee, Ms. Regina Jaffe, dated November 20, 1985 (see Finding of Fact "10") which included worldwide net profit data requested at conference. Therefore, in 13 days Reuters was able to assemble worldwide figures without incurring those costs estimated by Mr. Canty.

The ability of Reuters to file the 1977 return and to provide figures to the conferee strongly suggests that its estimated costs of compliance are greatly exaggerated and not a burden on foreign commerce.

As mentioned above, Reuters was well aware of the hazards of doing business in New York as a branch as opposed to a subsidiary and it chose to be treated as such. The fact that it is not as advantageous as other forms of business is not a ground for finding the New York statute or regulations unconstitutional as applied.

D. There was discussion of Zurich Insurance Co. v. New York State Tax Commission (144 AD2d 202) by both parties in their briefs. In Zurich, the court found that the New York branch of a foreign bank qualified for treatment as a separate taxable entity. However, New York Insurance Law § 4103(b) requires that certain assets must be maintained by the insurance company for the protection of its policyholders. The court felt that this placed the branches in the same stead as a corporation formally incorporated in New York. Without reaching the inapposite facts of that case, it suffices to say that Reuters is not engaged in a regulated industry subject to special taxation. The fact that New York treats other more stringently regulated businesses differently, *i.e.* Article 33 corporations, does not impact on its taxation of a branch office of Reuters, an Article 9-A company. Nor is its taxation of insurance companies relevant to the constitutional application of the law and regulations in the instant matter.

E. For all of the reasons set forth above, the petition of Reuters, Ltd. is denied and the three notices of deficiency dated October 14, 1983, as modified at conference (see Finding of Fact "10") are sustained, together with such additional interest as may be due and owing.

DATED: Troy, New York
February 22, 1990

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE